

ST 98-35

Tax Type: SALES TAX

Issue: Unreported/Underreported Receipts (Non-Fraudulent)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

THE DEPARTMENT OF REVENUE	)	Docket No.	97-ST-0000
OF THE STATE OF ILLINOIS	)	IBT No.	0000-0000
	)	NTL Nos.	SF1997000000000001
v.	)		SF1997000000000002
	)		SF1997000000000003
"STROMBOLI, INC.",	)		SF1997000000000004
)		
Taxpayer.	)	John E. White,	
	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: George Skontos, for "Stromboli, Inc." Alan Osheff
appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose when "Stromboli, Inc." ("Stromboli" or "taxpayer") protested four Notices of Tax Liability ("NTL") the Illinois Department of Revenue ("Department") issued to it following audit. NTL number SF1997000000000001 assessed Retailers' Occupation Tax ("ROT") regarding the period beginning 7/1/93 through and including 11/30/93. NTL number SF1997000000000002 assessed Metropolitan Pier and Exposition Authority Tax ("MPEAT") regarding the same period. NTL numbers SF1997000000000003 and SF1997000000000004 assessed, respectively, ROT and MPEAT regarding the period from 12/1/93 through and including 6/30/96.

During a pre-hearing conference counsel for the parties agreed that the issue to be resolved at hearing was whether "Stromboli" underreported its taxable gross receipts on the ROT returns it filed with the Department during the audit period. I have reviewed the

evidence adduced at hearing, and I am including in this recommendation findings of fact and conclusions of law. I recommend the issue be resolved in favor of the taxpayer.

Findings of Fact:

Facts Regarding "Stromboli's" Business:

1. "Stromboli" is an S corporation engaged in the business of making retail sales of ready to eat meals and liquor, at 000 West "Anystreet", Chicago, Illinois. Department Ex. 2 (kind of business); Department Exs. 7-9 (federal income tax returns for, respectively, 1993, 1994, 1995) (Schedule B, line 2 of each return).
2. "Vito Tanuchi" is the sole officer of taxpayer, and he testified at hearing. Tr. pp. 174-235 (testimony of "Vito Tanuchi" ("Tanuchi")).
3. When a customer ordered liquor or a soft drink from "Stromboli's" bar, taxpayer's employees did not prepare a guest check regarding the transaction, but merely rang up the transaction on the cash register. Tr. pp. 177-78, 219-20, 231-32 ("Tanuchi"); *see also* Tr. p. 42 (testimony of auditor Fred Van Buren ("Van Buren")), that he understood "bar" sales as being from "strictly beverages"); Taxpayer Exs. 3-4. When a customer ordered liquor with a meal, taxpayer's employees prepared a guest check, and identified on that check the sale price for each item ordered. Tr. pp. 231-32 ("Tanuchi").

Facts Regarding "Stromboli's" Books and Records and the Department's Audit:

4. At the end of the day, taxpayer records the gross receipts taken in that day on an envelope received from its accountant. Taxpayer Exs. 3-4; Tr. pp. 177-78 ("Tanuchi").
5. Within that envelope, taxpayer inserted two "z-run" cash register tapes regarding

gross sales made for that day. Taxpayer Exs. 3-4. One z-tape bore handwriting indicating that it was from “lunch” sales, and one bore handwriting showing a total for “bar” and one total for “food”. Taxpayer Exs. 3-4.

6. The totals of the two z-tapes included in each daily envelope equaled the amount recorded on the back of the envelope for the day’s total sales. Taxpayer Exs. 3-4; Tr. pp. 177-78 ("Tanuchi"). Neither the lunch z-tape, nor the food z-tape broke down the total sales of liquor versus the total sales of food. Taxpayer Exs. 3-4.
7. The envelopes indicated the amount of gross receipts "Stromboli" received from sales where payment was made via credit card. Taxpayer Ex. 3-4. The daily envelope also included the amount of any payments taxpayer made for supplies, etc., as well as the receipts given to taxpayer from vendors regarding those payments or disbursements. *See* Taxpayer Exs. 3-4.
8. At hearing, taxpayer offered as its group exhibit 4, all of the daily envelopes taxpayer used, completed and retained as business records regarding the audit period. Taxpayer Group Ex. 4; Tr. pp. 129-33 (testimony of "Meyer Lansky" (“Lansky”)). That exhibit was admitted without objection. Tr. p. 133.
9. The contents of Taxpayer Ex. 4 show that, for August 1995, "Stromboli" recorded, in part, the following information regarding its daily receipts:

day - date	lunch sales	bar sales	food sales	bar & food total	total reported sales
Tu - 8/1	743.64	205.65	469.24	674.89	1,418.53
W - 8/2	779.00	179.10	361.00	540.10	1,319.10
Th - 8/3	826.67	220.95	325.58	546.53	1,373.20
F - 8/4	960.61	320.15	418.06	738.21	1,698.82
M- 8/7	663.64	126.45	260.16	386.61	1,050.25
Tu - 8/8	788.83	167.90	288.77	456.67	1,245.50
W - 8/9	860.42	202.05	222.93	424.98	1,285.40

Th - 8/10	821.02	206.45	339.81	546.26	1,367.28
F - 8/11	951.57	243.80	455.42	699.22	1,650.79

(continued on next page)

day - date	lunch sales	bar sales	food sales	bar & food total	total reported sales
M - 8/14	755.25	226.75	272.73	499.48	1,254.73
Tu - 8/15	736.13	158.70	274.54	433.24	1,169.37
W - 8/16	912.45	244.78	276.12	520.90	1,433.35
Th - 8/17	717.18	182.45	306.11	488.56	1,205.74
F - 8/18	881.66	297.30	336.54	633.84	1,515.50
M - 8/21	685.49	167.25	237.61	404.86	1,090.35
Tu - 8/22	726.04	169.80	330.14	499.94	1,225.98
W - 8/23	708.03	242.10	312.42	554.52	1,262.55
Th - 8/24	861.31	228.45	332.03	560.48	1,421.79
F - 8/25	1,008.27	283.70	422.90	706.60	1,714.87
M - 8/28	529.28	155.25	299.44	454.69	983.97
Tu - 8/29	668.22	137.75	405.18	542.93	1,211.15
W - 8/30	851.07	255.10	295.59	550.69	1,401.76
Th - 8/31	838.29	196.15	365.86	562.01	1,400.30
AUGUST 1995 TOTALS	18,274.07	4,818.03	7,608.18	12,426.21	30,700.28

Taxpayer Ex. 4.

10. Taxpayer receives most of its receipts from selling food and drinks during its lunch business. *See* Taxpayer Group Ex. 4 (cash register tapes in daily envelopes).
11. The z-tape labeled “lunch” is prepared after "Stromboli's" lunchtime business has concluded. Tr. pp. 177, 220 ("Tanuchi"). Thereafter, taxpayer’s employees use the register at the bar to ring up all of its sales. *Id.*, p. 220.
12. Sales to persons at the bar, for which no guest receipt is prepared, are labeled as “bar” sales on "Stromboli's" books and records. Tr. pp. 177, 219-20 ("Tanuchi"); Taxpayer Exs. 3-4.
13. On the daily z-tapes, "Stromboli's" receipts from sales for which a guest receipt is

- prepared are labeled “food” sales; on "Stromboli's" daily envelopes, such receipts are labeled “restaurant” sales. *See* Taxpayer Ex. 3-4; Tr. pp. 177, 219-20, 230-32 ("Tanuchi").
14. During the audit, the Department’s auditor, Van Buren, compared a schedule of "Stromboli's" liquor purchases with the entries labeled “bar” sales in "Stromboli's" accountant’s summaries of "Stromboli's" books and records. Taxpayer Ex. 2; Tr. pp. 50-51, 254 (Van Buren).
 15. Van Buren’s comparison showed that, from July 1995 to June 1996, taxpayer spent approximately \$53,000 to purchase liquor,¹ and that it recorded that it had approximately \$60,000 in “bar” sales. Taxpayer Ex. 2; Tr. pp. 50-51, 254 (Van Buren).
 16. Although Van Buren testified that he concluded, based on his comparison, that "Stromboli" was selling liquor at a loss, he did not actually believe that conclusion. Tr. pp. 74-75 (since Van Buren found it highly unusual to sell at a loss, he applied a mark-up analysis for the entire audit period). Instead, he concluded that "Stromboli" was not accurately reporting all of its gross receipts on line 1 of its ROT returns. Taxpayer Ex. 2; Tr. pp. 74-75 (Van Buren).
 17. Once Van Buren rejected the amounts of gross receipts "Stromboli" reported on its ROT returns, he devised a “mark-up analysis” formula to measure "Stromboli's" “expected sales.” Taxpayer Ex. 2, p. 3; Department Ex. 10; Tr. p. 75 (Van Buren). That formula multiplied "Stromboli's" payments for food and liquor

¹ While the auditor broke down his estimates of taxpayer’s purchases into purchases of beer, wine and liquor (i.e., spirits), in this recommendation, I will use the term “liquor” to refer to alcoholic beverages in general.

during a given sample period by various mark-up percentages, which were determined for different types of products purchased. Department Ex. 10 (different mark-ups used for beer, wine, liquor and food); Taxpayer Ex. 2; Tr. p. 36 (Van Buren).

18. The Department's corrections of returns were prepared using the amount of net "expected sales," as calculated by Van Buren's mark-up analysis, as the tax base. Department Exs. 2, 4, 10; Taxpayer Ex. 2; Tr. p. 75 (Van Buren).

Conclusions of Law:

The Department introduced its corrections of "Stromboli's" returns into evidence under the certificate of the Director. Department Exs. 2, 4. The Department's correction of a taxpayer's returns constitutes *prima facie* proof of the correctness of the amount of tax due. 35 ILCS 120/4. The Department's *prima facie* case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279 (1943). A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's proposed assessment. A.R Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1st Dist. 1988). Instead, a taxpayer must present evidence that is consistent, probable and identified with its books and records to show that the proposed assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333 (1958); A.R Barnes & Co., 173 Ill. App. 3d at 833-34.

"Stromboli" asserts that: it did not underreport its receipts; its returns were true and accurate; the amounts reported by it on its ROT returns were based on and supported by the books and records it created and kept in the regular course of its business; and the Department's NTL's were based on a "biased and skewed audit." See Taxpayer Ex. 1

(protest); Tr. pp. 267-280 ("Stromboli's" closing argument). The Illinois supreme court has held that, to survive attack, the Department's audit method must meet a minimum standard of reasonableness. Fillichio v. Department of Revenue, 15 Ill. 2d at 333; Masini v. Department of Revenue, 60 Ill. App. 3d 11, 14 (1978). In practice, the taxpayer bears the burden to show that the audit method used failed to meet that standard. See Vitale v. Department of Revenue, 118 Ill. App. 3d at 210, 213 (3d Dist. 1983).

At hearing, "Vito Tanuchi", "Stromboli's" officer, testified after the Department presented its *prima facie* case. Tr. pp. 174-234 ("Tanuchi"). He described how "Stromboli's" business was conducted. "Tanuchi" explained how the business prepared the envelopes on which it reported receipts as being from either the bar or from the restaurant. Those daily envelopes, their contents, and the accounting summaries "Meyer Lansky", "Stromboli's" accountant, prepared after receiving those daily envelopes, were also introduced into evidence. Taxpayer Exs. 3-5.

Here, it cannot be disputed that taxpayer kept and maintained sufficient records to show, e.g., its total purchases, total gross receipts, and count of inventory at least once a year. 86 Ill. Admin. Code § 130.801; Taxpayer Exs. 3-5; Department Exs. 7-10; Tr. p. 35 (Van Buren). Moreover, the auditor stated in his audit narrative, and testified at hearing, that he was able to reconcile those records with the information reported on "Stromboli's" federal income tax returns. Taxpayer Ex. 2, p. 2; Tr. pp. 35-36 (Van Buren). If "Stromboli" was underreporting taxable receipts on its ROT returns, it was also cheating on its federal income tax returns.

The Department corrected "Stromboli's" returns because the Department auditor rejected the amount of taxable gross receipts "Stromboli" reported on its ROT returns.

See Department Exs. 2, 4. The auditor rejected those amounts of taxable gross receipts reported by "Stromboli" because, he testified, he found "Stromboli's" records to be contradictory. Tr. p. 37 (Van Buren). Van Buren's conclusion that "Stromboli's" books and records were inconsistent with one another was based on a comparison he made of summaries of entries on taxpayer's books labeled "bar" sales with summaries of "Stromboli's" liquor purchases. When making that comparison, Van Buren assumed that the entries labeled "bar" sales included all of "Stromboli's" receipts from selling liquor. See Tr. p. 42 (Van Buren). Proceeding under that assumption, and after his comparison of those books and records showed that "Stromboli" scheduled approximately \$53,000 in "bar" sales during the same period it purchased approximately \$60,000 worth of liquor, Van Buren concluded that "Stromboli" was either selling liquor at a loss (see Tr. pp. 74-75 (Van Buren)), or that it was underreporting its total sales. *Id.*; see also Taxpayer Ex. 2.

After the auditor made his comparison, and drew the latter conclusion, he asked "Stromboli's" accountant about it. "Lansky", taxpayer's accountant, relayed the question to "Tanuchi", following which "Lansky" told the auditor that the amounts recorded as "bar" sales did not include all of "Stromboli's" sales of liquor. Tr. pp. 138-40 ("Lansky"), Taxpayer Ex. 2, pp. 2-3 (auditor's comments referring to "Stromboli's" explanation). In his comments, and after recounting "Stromboli's" explanation of the inconsistency the auditor was convinced he had found, the auditor wrote:

To analyze this contention a mark-up analysis was conducted for the period of July 1995 through June 1996. To conduct this analysis "Stromboli's" sales price of wine, beer, and mixed drinks was determined.

* * *

Taxpayer Ex. 2, p. 3.

Proof of "Stromboli's" contention, however, did not require a quantitative analysis, but a qualitative one. Specifically, what needed to be tested was the truth of "Stromboli's" contention that the entries in its books and records labeled "bar" sales did not include all of its receipts from selling liquor.² But Van Buren never tested the truth of that contention. Instead, and clearly convinced — despite his repeated denials that he held the conviction (*see* Tr. pp. 38, 40, 73 (Van Buren)) — that "Stromboli" was not reporting all of its gross receipts, Van Buren performed a quantitative analysis which multiplied the dollar amount of "Stromboli's" food and liquor purchases during one year in the audit period by different "mark-up factors" which he calculated for different products. Department Ex. 10, pp. 4-5; Tr. pp. 50-51 (Van Buren). Calculations and projections like those Van Buren used are ordinarily performed where a taxpayer fails to keep records required to support the information included on its returns. *E.g.*, Vitale v. Illinois Department of Revenue, 118 Ill. App. 3d 210, 213 (1983). Again, the information at issue here is the amount of gross receipts "Stromboli" realized from selling tangible personal property at retail, which amounts it was required to report on line 1 of its returns.

The Department has promulgated regulations to inform retailers of the types of records they must maintain. 86 Ill. Admin. Code §§ 130.801 - 130.810. Department rule 130.805 provides:

- a) In General. A taxpayer shall maintain all records that are necessary to a determination of the correct tax liability under the Act. All required records must be made available on request by the Department. Where a taxpayer's business consists exclusively of the sale of

² And if a quantitative analysis were required after the truth of "Stromboli's" contention was tested, the items to be counted would have been the percentage or amounts of "restaurant" receipts that came from "Stromboli's" sales of liquor. *See, e.g.*, Tr. pp. 139-41 ("Lansky").

tangible personal property at retail, the following records will be deemed by the Department to constitute a minimum for the purposes of the Act:

- 1) Cash register tapes and other data which will provide a daily record of the gross amount of sales.
- 2) A record of the amount of merchandise purchased. To fulfill this requirement, copies of all vendors' invoices and taxpayers' copies of purchase orders must be retained serially and in sequence as to date.
- 3) A true and complete inventory of the value of stock on hand taken at least once each year.

86 Ill. Admin. Code § 130.805.

In his comments, Van Buren justified his mark-up analysis by stating that "Stromboli" "retained no back up material ... such as register tapes [and] [i]n the exam period "Stromboli's" books consisted merely of entering two daily sales totals, (one for bar and one for restaurant), on a piece of paper." Taxpayer Ex. 2., p. 5. He also stated:

Audit Conclusion & Status

The audit findings were discussed with "Stromboli's" attorney George Skontos. Mr. Skontos stated that he is disagreeing with the audit findings based on the fact that "Stromboli" has presented books & records for the audit period and these should be accepted as correct.

The auditor is not disputing the presentation of the books and records but is disputing the accuracy & competency of the records. Neither "Stromboli" nor Mr. Skontos has presented any documentation or evidence explaining the difference in expected sales versus reported sales.

In regard to the above difference it should be noted that the sale price and purchase amounts used in the computation came directly from "Stromboli's" records. Thus it is "Stromboli's" own records that are inconsistent when subjected to the mark-up analysis.

Taxpayer Ex. 2, pp. 3-4 (emphasis added). At hearing, Van Buren testified that he recalled reviewing only sheets of paper with "Stromboli's" daily sales figures during his

audit (*see* Tr. pp. 48-50, (Van Buren)), but he could not rule out the possibility that he might have seen the daily envelopes later admitted as taxpayer exhibits 3 and 4. Tr. pp. 69-70 (Van Buren).

The evidence shows that "Stromboli's" actual books and records were available for Van Buren's review during the audit, but that he never examined them. Instead, he examined an accountant's summaries of those records. Had he examined the records themselves, he would have noticed that "Stromboli" *did* make and keep cash register receipts showing daily gross receipts. Taxpayer Exs. 3-4 (contents of daily envelopes include separate register receipts showing day's gross receipts). Both the actual records and the summaries were admitted as evidence at hearing, without objection. Taxpayer Exs. 3-5; Tr. p. 133.

I have reviewed the cash register tapes included in each of the daily envelopes "Stromboli" maintained for the audit period, and those tapes show the amounts of gross receipts "Stromboli" documented as having received each day. Taxpayer Exs. 3-4; 86 Ill. Admin. Code § 130.805(a)(1). The Department does not dispute that the sum of those entries correspond with the amounts of gross receipts "Stromboli" reported on the returns it filed during the audit period. Taxpayer Ex. 2 (auditor's narrative). I find no evidence in the record that supports the auditor's conclusion that those records are not accurate. *See* Taxpayer Ex. 2, p. 4.

The question that remains, however, involves the truth of "Stromboli's" contention that its "bar" sales do not include all of its receipts from selling liquor. Had "Stromboli" maintained its daily guest receipts, that is, the checks its employees wrote for each order of food (and drink, if "Tanuchi's" testimony is to be believed (*see* Tr. pp. 231-

32 ("Tanuchi")) sold to customers, and had those checks in fact, reflected separate charges for food and liquor, this case probably would not have proceeded to hearing. Such evidence would have clearly documented that the entries on "Stromboli's" books labeled "restaurant" sales included receipts from selling liquor. Notwithstanding "Stromboli's" failure to keep and present at hearing the records it purports to have made, "Tanuchi's" testimony is not so incredible as to be unworthy of belief. Novicki v. Department of Finance, 373 Ill. 342, 345 (1940).³ In fact, I find his testimony intuitively credible.

"Tanuchi's" testimony has the added benefit of being closely identified with "Stromboli's" books and records which show that, every day, "Stromboli" made and kept separate cash register receipts for "lunch" sales, as well as for "bar" and "food" sales. "Stromboli's" "lunch" business produced the greatest amount of gross receipts each day — more than the total amount of its combined daily "bar" and "food" sales. Taxpayer Exs. 3-4; *see also* Table, *supra*, pp. 3-4. The corollary to the auditor's assumption that "Stromboli's" "bar" sales included all of its reported sales of liquor, is that its "food" and

³ Taxpayer, however, should not assume that it need not keep and maintain its daily guest checks. The records "Stromboli" presented at hearing were sufficient to corroborate the amounts of its daily gross receipts, and that evidence was probative of the fact issue to be resolved at hearing. However, had the issue involved, for example, the Department's disallowance of the deductions "Stromboli" took on its monthly ROT returns for the amount of tax charged and collected from its customers during the audit period, taxpayer would have needed more than the records it introduced at this hearing to rebut the Department's *prima facie* case. 35 ILCS 120/4, 120/7.

The cash register tapes "Stromboli" introduced at hearing do not identify every separate transaction for each day of the audit period, they only identify each day's total gross receipts. Those cash register receipts would have been insufficient to show that "Stromboli" charged and collected tax as an item separate and distinct from its charges for the food and drink it sold. *Compare* 86 Ill. Admin Code § 130.805 (What Records Constitute Minimum Requirement) *with* 86 Ill. Admin Code § 130.810 (Records Required to Support Deductions). Nor could taxpayer have prevailed by offering an officer's testimony that "Stromboli" always charged and collected tax on its sales, since testimony alone cannot be used to distinguish taxable from nontaxable receipts. A.R Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1st Dist. 1988).

“lunch” receipts would have included no receipts from selling liquor. That, in turn, would mean that no customer ever ordered any beer, wine or liquor during "Stromboli's" lunch. While that inference is, perhaps, possible, it strikes me as neither probable nor reasonable, and it was contradicted by "Tanuchi's" credible testimony that "Stromboli" sold liquor during lunch. Tr. p. 178 ("Tanuchi").

"Stromboli" introduced credible testimony and books and records to support its contention that the entries on "Stromboli's" books showing “bar” sales included only the receipts from beverage sales made without a guest check, and its “restaurant” sales included all other receipts, including those receipts from sales of liquor with food, either during or after lunch. The same evidence supports "Stromboli's" claim that the audit method used in this case was skewed. Specifically, the audit method used here ignored "Stromboli's" competent and rational explanation of its own books and records, as well as the content of those records, which corroborate the amount of gross receipts "Stromboli" reported on the returns it filed during the audit period. I conclude, therefore, that "Stromboli" rebutted the Department’s *prima facie* case.

After "Stromboli" rebutted the Department’s *prima facie* case, the burden shifted back to the Department to prove its case by competent evidence. Novicki v. Department of Finance, 373 Ill. at 345-46. The Department introduced no competent or credible evidence to support its contention that "Stromboli" underreported taxable receipts.

Conclusion:

I recommend that the amounts of tax, penalties and interest identified on the Notices of Tax Liability issued against "Stromboli", be revised to show no liability, and

that those assessments be finalized as revised.

Date

Administrative Law Judge